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SUBJECT: IMF AND WORLD BANK: UKRAINE STALLED ON BUDGET

REF: A. KYIV 954

[1](#)B. KYIV 576

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[1](#)1. (SBU) Summary. The IMF and World Bank have told us that they do not foresee any net revenues or fiscal savings in the pipeline for Ukraine's strapped budget. Additionally, Ukraine has stalled on necessary reforms to qualify for a World Bank DPL loan. Ukraine's parliament increased excise taxes on beer on June 3, a move that is expected to generate roughly UAH 300 million (\$38 million) for the remainder of [1](#)2009. Nonetheless, Ukraine's authorities will likely end up with a revenue-neutral measure, as the Rada also passed a budget amendment that would increase outlays to four disparate programs. Both the IMF and the World Bank separately acknowledged that such paltry sums being wrangled over in parliament, combined with a lack of credible structural measures, indicate how deadlocked the Rada will likely remain on fiscal issues over the weeks to come. End summary.

World Bank Loan Off-Track

[1](#)2. (SBU) World Bank Kyiv-based Senior Economist Ruslan Piontkivsky told us on June 4 that the \$500 million Development Policy Loan (DPL), previously targeted for July disbursement, was significantly off-track. The Bank had not come close to completing its appraisals or entered into sustained negotiations, due to the lack of GOU progress on structural measures. Piontkivsky said a July timeframe for DPL disbursement was "impossible," and he stressed that the World Bank still considered GOU progress on the IMF's macroeconomic targets to be "essential." Piontkivsky commented that the World Bank's \$750 million loan for bank recapitalization could be disbursed sooner than the DPL. In any case, he said, the two loans would "not be wrapped in the same package."

[1](#)3. (SBU) There had been discussion "at the top" echelons of the World Bank about expanding 2009 lending to Ukraine, but even proponents of a loan expansion acknowledge that the Ukraine program is already beyond normal risk limits. Piontkivsky called the idea of reducing Ukraine's budget deficit through a World Bank bond issue "a long shot," given the logistical and time constraints of creating and implementing such a program.

Money In, Then Out Again

[1](#)4. (SBU) A June 3 measure passed by the Rada will increase

excise taxes on beer (from UAH 0.34 to 0.54 per liter) for the balance of 2009. The IMF's Kyiv-based budget expert Igor Shpak anticipates that the taxes will only generate about UAH 300 million (\$38 million), hardly enough to make a dent in Ukraine's overall fiscal deficit of roughly 4 percent of GDP.

Moreover, the Rada also passed amendments to the budget that would allocate the new revenues to four separate programs. Spending will be increased for diabetes medicines and local budget subsidies in Crimea (UAH 160 million), water treatment facilities in Lviv (UAH 105 million), and restoration of the Shevchenko national reserve in Kaniv (UAH 22.5 million). The IMF's Shpak estimated that the latter program is a sop to President Yushchenko, decreasing the likelihood of a presidential veto. Taken in sum, the June 3 measure is revenue-neutral at the precise moment Ukrainian authorities are facing a large budget gap with no immediate financing prospects.

15. (SBU) The actual effect of the law may be to reduce tax revenues from the sale of beer. Brewery output has already declined this year, falling 20 percent in the first quarter of 2009. Rada deputy Yaroslav Dyodyk (Our Ukraine) noted during plenary debate that breweries with large dollar borrowings and imported inputs had faced a cash crunch, due to hryvnia depreciation and a drop in consumption. However, the IMF's Shpak was more equivocal. Although he acknowledged the possibility of elasticity, he pointed out that the beer market is concentrated in the hands of three or four major producers, each of which is likely to survive a downturn. Shpak predicted that because the excise tax increase would go into effect during the summer when beer consumption was highest, the new price levels would be fully accepted by the

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public within weeks. Shpak noted that the June 3 legislation constitutes another expansion of the excise tax regime for alcohol products. Excise taxes were most recently amended on March 31, when the Rada passed two IMF-supported anti-crisis measures (ref B).

16. (SBU) The IMF does not anticipate any constructive progress on fiscal policy in the coming weeks. In fact, according to Shpak, the only budget-related measures in the Rada's legislative pipeline could result in a net decrease for the treasury. A May 22 biofuels law grants generous tax incentives to both producers and consumers. The IMF worries that any positive environmental and energy security outcomes from this law would be offset by losses in revenue, since the State Tax Administration would have difficulty distinguishing between types of fuel in its tax levies and collections. Additionally, a measure on VAT exemptions for agricultural producers had been passed that, in essence, could allow for broader indirect subsidies. The IMF suggested that the President was being heavily lobbied to sign the VAT legislation, but Shpak could not estimate how much revenue might be lost if the law came into effect.

17. (SBU) Comment. Ukraine's paltry efforts at raising revenue amidst a severe budget crisis, combined with the authorities' easy willingness to spend any gains, reveals that the Rada and the GOU are still not taking collective or unified responsibility for fiscal policy, perhaps thinking that the IMF and World Bank, along with other possible bilateral donors, eventually will come along with support. Given what we have heard from the IMF resident representative on June 2 (ref A) and the World Bank on June 4, however, it appears the international community likely will not be in Kyiv bearing gifts to offset Ukraine's budget deficit anytime soon.

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